Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2061

Date: 07-Feb-13
From: Steve Leimberg's Estate Planning Newsletter
Subject: **Gassman, Crotty, Buschart & Moody on the $28,000,000 Mistake: Underestimating the Value of a Bypass Trust and Overestimating the Value of Spousal Estate Tax Exclusion Portability**

"Tax and financial advisors are now evaluating which clients will no longer need Bypass trust arrangements and which clients may have more of a need than ever. So often, we think in terms of only present values, without taking into account growth in value, inflation, future earnings, and possible remarriages.

Gassman Law Associates, P.A. designed a spreadsheet system to evaluate the estate tax savings that can be achieved through full utilization of a bypass trust, as opposed to simply relying on estate tax exclusions and spousal portability. Our calculations found that, based on historical S&P 500 returns, the estate tax savings of a bypass trust over a 30 year period could realistically run into the tens of millions of dollars!

These spreadsheets demonstrate the significant value of Bypass trusts for purposes of estate tax savings, as opposed to solely relying on spousal estate tax exclusion portability. In determining whether to use a Bypass trust, it is extremely important to run the numbers to show clients the estimated estate tax savings of each strategy and allow them to ultimately decide which strategy to implement. We cannot rely on today's values and gut feelings in making these estate planning decisions.

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(IRAs), sitting (with clients) and shaking (up previously held assumptions)."

We close this week with important commentary by **Alan Gassman**, **Kenneth Crotty**, **Rick Buschart** and **Eric Moody** that illustrates the dangers of underestimating the value of a bypass trust and overestimating the value of spousal estate tax exclusion portability.

Alan S. Gassman, J.D., LL.M. practices law in Clearwater, Florida. Each year he publishes numerous articles in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, The Journal of Asset Protection, and Steve Leimberg's Asset Protection Planning Newsletters. Mr. Gassman is a fellow of the American Bar Foundation, a member of the Executive Council of the Tax Section of the Florida Bar, and has been quoted on many occasions in publications such as The Wall Street Journal, Forbes Magazine, Medical Economics, Modern Healthcare, and Florida Trend magazine. He is an author, along with Kenneth Crotty and Christopher Denicolo, of the BNA Tax & Accounting book Estate Tax Planning in 2011 and 2012. He is the senior partner at **Gassman Law Associates, P.A.** in

Clearwater, Florida, which he founded in 1987. His email address is agassman@gassmanpa.com

Kenneth J. Crotty, J.D., LL.M., is a partner at the Clearwater, Florida law firm of **Gassman Law Associates, P.A.**, where he practices in the areas of estate tax and trust planning, taxation, physician representation, and corporate and business law. Mr. Crotty has co-authored several handbooks that have been published in BNA Tax & Accounting, Estate Planning, Steve Leimberg's Estate Planning and Asset Protection Planning Newsletters, Estate Planning magazine, and Practical Tax Strategies. Mr. Crotty is also the author of the Limited Liability Company Chapter of the Florida Bar's Florida Small Business Practice, Seventh Edition. He, Alan Gassman and **Christopher Denicolo** are the co-authors of the BNA book Estate Tax Planning in 2011 & 2012. His email address is Ken@gassmanpa.com.

Rick Buschart is a shareholder at **Bollenback & Forret, PA, CPAs and Consultants**. His responsibilities include providing Business Valuation/Litigation Support and Estate/Trust planning and compliance services to the firm's clients. Rick also has extensive experience in individual, corporate and partnership tax planning and preparation, and trustee and personal representative fiduciary accountings. Rick has over sixteen years of public accounting experience and over eighteen years of combined legal and accounting experience. Rick received his law degree and his Masters in Tax Law (LL.M) from the Washington University School of Law where he specialized in business law and taxation as well as estate planning and taxation. Rick is a past president and member of the Board of Directors for the Pinellas County Estate Planning Council, Inc., is a current board member of the Clearwater Chamber of Commerce, and is a current member of the Financial Counseling Services Committee for Morton Plant Mease Foundation. He is the current Treasurer and board member of Leadership Pinellas, Inc., is a past Treasurer and current Trustee for Directions for Living, Inc., and is a current member of the American Institute of Certified Public Accountants (AICPA), the Florida Institute of Certified Public Accountants (FICPA), and the National Association of Certified Valuation Analysts (NACVA). Rick is also an associate member of the Clearwater Bar Association and an inactive member of the Missouri Bar Association.

Eric Moody is a recent graduate of the Stetson University College of Law, where he was an Articles and Symposia Editor for the *Stetson Law Review*. Eric is scheduled to sit for the Florida Bar examination in February and would like to pursue a career in estate planning/asset protection or property. In 2009, Eric received a B.S. in Business Management from the University of South Florida. Prior to pursuing a career in law, Eric spent seven years managing a successful on-line retail business. Eric's email address is Eric@gassmanpa.com.

Here is their commentary:

EXECUTIVE SUMMARY:

Tax and financial advisors are now evaluating which clients will no longer need Bypass trust arrangements and which clients may have more of a need than ever. So often, we think in terms of only present values, without taking into account growth in value, inflation, future earnings, and possible remarriages.

We have found that our initial impressions on how to advise clients are not always the best answers after running a number of spreadsheet analyses and in many situations clients relying on portability will pay an unexpected amount of estate tax.

FACTS:

Gassman Law Associates, P.A. designed a spreadsheet system to evaluate the estate tax savings that can be achieved through full utilization of a bypass trust,

as opposed to simply relying on estate tax exclusions and spousal portability. Our calculations found that, based on historical S&P 500 returns, the estate tax savings of a bypass trust over a 30 year period could realistically run into the tens of millions of dollars!

We ran several scenarios to simulate the growth of investment assets and the estate tax savings of a bypass trust under both historical S&P 500 returns and more "realistic" return rates. In the first scenario, a married couple relies solely their estate tax exclusions and spousal portability. In the second scenario, the couple places half of their investment assets into a living trust that will become a bypass trust upon the first spouse's death, while the surviving spouse retains and invests the remaining half. In the third scenario, the married couple invests all of their investment assets into a living trust that will become a bypass trust upon the death of the first spouse. All three scenarios consider other major factors that will impact estate tax liability for the client, which have been adjusted for historic growth rates, such as the family home, continued investments by the surviving spouse, and growth of the estate tax exclusion.

You may be shocked at the results described below. To view a PDF copy of these spreadsheets, please **click here**

If you were to have invested $5,250,000 in the S&P 500 in 1981, it would be worth over $100,000,000 now! At the same time, if the estate tax exclusion was $5,250,000 in 1981 and grew at the Consumer Price Index rate over the same thirty-year period, the exclusion would have only risen to about $12,600,000.

Many people think that the actual rate of inflation is substantially higher than the government adopted CPI index, and that clients should not assume that their exemptions are going to grow at the actual rate of inflation. If our calculation of the actual rate of inflation (one percentage higher than the CPI index) is correct, then the growth of the $5,250,000 exclusion over the same historic thirty-year period would be $16,832,454 instead of $12,595,497.

To determine how the numbers may play out and the potential estate tax savings of a Bypass trust, we assumed that a couple had $5,250,000 in investment assets and had a home valued at $2,000,000 at the first spouse's death. We ran three scenarios: (1) The spouses do not set up a Bypass trust and instead rely on portability and the combined exclusions on the second spouse's death; (2) The first dying spouse places half of the couple's investment assets ($2,625,000) into a living trust to become a Bypass trust, while the surviving spouse retains and invests the remaining half; (3) The spouses place all of their

investment assets in a joint trust that would become a Bypass trust upon the first death. We also assumed that the surviving spouse would save $100,000 a year after paying taxes and making gifts. In order to stay conservative, we have also assumed that this $100,000 net amount will not increase with inflation as it would normally be expected to do.

We then calculated the surviving spouses' estate tax liability in each of the above scenarios using two sets of numbers. The first set of numbers assumed the investments, both the initial and the yearly additions, grew at the Compound Annual Growth Rate of the S&P 500 from 1982 to 2011 (10.98%), with all dividends reinvested. The second set assumed the investments grew at a relatively conservative after-tax rate of 7% per year, with all dividends reinvested. In both sets of data, we assumed yearly 1.5% fees and costs for the investments and trusts. We also assumed that the family home values and the estate tax exclusion grew at their historical Compound Annual Growth Rates from 1982 to 2011.

We know it sounds complicated, but the charts make it very easy to follow.

And what we found is very simple: Assuming that a spouse survives for thirty years after the passing of the first spouse, the use of a Bypass trust under the conservative investment growth projections could result in estate tax savings of almost $8,000,000; or under historical growth projections, **estate tax savings of over $28,000,000! That is not a typo: $28,000,000!**

In other words, DO NOT RELY ON PORTABILITY AND THE CONSUMER PRICE INDEX TO FACILITATE AVOIDANCE OF FEDERAL ESTATE TAX!

COMMENT:

What does the above example show us?

1. You have to run the numbers! Common sense would indicate that this couple did not have a serious estate tax concern with a standard “one-half each” Bypass trust plan, but the numbers give a much clearer version.
2. Run the numbers with the clients to show them the different assumptions and scenarios so that they can make their own decisions.
3. Decide whether to offer joint revocable trusts that will fund a credit shelter trust on the first death, the same way as occurred in Private Letter Rulings 200210051 and 200101021, or other previous lesser used techniques. There are many complexities associated with these trusts, and they will not likely qualify as tenancy by the entireties assets from a creditor protection standpoint if ever challenged by a creditor, but other creditor protection techniques can be employed as and when needed.
4. Keep in mind that the married couple in the above example can ameliorate the estate tax risk by utilizing annual gifting, discount planning, and other important estate planning tools.

We also ran a few other scenarios in the spreadsheet. In Scenario One, if these same clients did nothing and one spouse died in 2013 and the couple’s $5,250,000 of investments grew at 7%, then 15 years later (in 2028) the surviving spouse would have a $17,019,386 estate and only a $13,381,812 combined exemption; so at the current 40% rate, the estate tax would be $1,455,030. If the investment grew at the historic S&P rate, the estate would be valued at $26,389,601, and the estate tax would be $5,203,116.

If the surviving spouse lived for 30 years with the same assumptions, then his or her estate would be worth $37,789,152 and the estate tax would be $7,977,462. These numbers are based upon a 7% rate of return. If the investment grew at the historic S&P rate (10.98%), the estate would be valued at $96,663,144 and the estate tax would be $31,527,059! If a Bypass trust was fully utilized, the estate tax of the surviving spouse would only be $3,242,857.

Alternatively, in Scenario Two, if the couple keeps their investment assets separate so that one-half would lock up in a Credit Shelter Trust (also known as a Bypass Trust or a Non-Marital Trust) after the first death, the numbers are much more tolerable but the tax is still formidable. Under this Scenario, If the investments grew at a 7%, then 15 years later, the surviving spouse would have a $11,246,016 estate and a combined exemption of only $10,756,812; so the estate tax due would be $195,682 (assuming a 40% rate). If the investment in Scenario Two grew at the historic S&P rate (10.98%), then the estate would be valued at $16,404,704 and the estate tax due would be $2,259, 157.

At 30 years, assuming a 7% growth rate, the surviving spouse's estate be worth $25,091,321 estate and the estate tax due would be $3,948,329 (assuming a 40% rate). However, if the investment in Scenario Two grew at the historic S&P rate (10.98%), then the estate would be valued at $58,682,892 and the estate tax due would be $17,384,958.

Conclusion

These spreadsheets demonstrate the significant value of Bypass trusts for purposes of estate tax savings, as opposed to solely relying on spousal estate tax exclusion portability. In determining whether to use a Bypass trust, it is extremely important to run the numbers to show clients the estimated estate tax savings of each strategy and allow them to ultimately decide which strategy to implement. We cannot rely on today's values and gut feelings in making these estate planning decisions.

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HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman

Kenneth Crotty

Rick Buschart

Eric Moody

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LISI Estate Planning Newsletter #2061 (February 7, 2013) at http://www.leimbergservices.com.

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